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No. 91-645

In The

Supreme Court of the United States

October Term, 1991

LEILA BUCHANAN,

Petitioner,

v.

FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION, as Receiver for First Texas Savings Association, Dallas, Texas, ET AL.,

and

FIRST GIBRALTAR BANK, FSB,

Respondents.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the Court of Appeals was correct in its determination that: (a) Buchanan's claims are barred by the protection given First Gibraltar Bank, FSB by the *D'Oench, Duhme* doctrine; and (b) First Gibraltar Bank, FSB cannot be charged with such "notice" of Buchanan's claims so as to defeat its protections under federal law.

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Respondent First Gibraltar Bank, FSB ("First Gibraltar") respectfully files this Brief in Opposition to the Petition for Writ of Certiorari of Petitioner Leila Buchanan ("Buchanan") and would show as follows:

STATEMENT OF THE CASE

This action was originally brought in Texas state court by Petitioner Buchanan seeking recovery of damages under the Texas Consumer Protection-Deceptive Trade Practices Act and a declaratory judgment voiding a foreclosure sale of her home conducted by First Texas Savings Association ("FTSA"). On January 26, 1989, the action was removed to federal district court by the Federal Savings and Loan Insurance Corporation ("FSLIC"), after its appointment as Receiver for FTSA. Subsequently, on May 3, 1990, First Gibraltar filed its Motion to Intervene as of Right or, Alternatively, for Permissive Intervention. First Gibraltar obtained an interest in the case after it acquired substantially all of the assets, but only certain tax, secured and deposit liabilities, of FTSA from the FSLIC as receiver for FTSA. On May 10, 1990, the district court granted First Gibraltar's Motion for Permissive Intervention. On July 6, 1990, the district court entered its Judgment dismissing Plaintiff's causes of action against First Gibraltar, holding that Buchanan's claims were barred by federal law.

First Gibraltar essentially agrees with the factual statement present by Buchanan, except for Buchanan's statement that: "While she was away from her homestead, her son contracted for siding work which was almost complete when she returned." [Petition, p. 3]. There was no support in the record below for this statement. Significantly, Buchanan's assertion is refuted by language of the Mechanic's and Materialmen's Contract with Power of Sale ("Mechanic's Lien Contract") executed by Buchanan in favor of FTSA stating that: "This contract is executed and delivered before any labor has

been performed and before any material has been furnished for the construction of the improvements for which the lien hereby created is given." No other statement or agreement regarding this matter exists in the books and records of FTSA.

SUMMARY OF THE ARGUMENT

In her action, Buchanan sought to void the foreclosure sale of her home, asserting that the mechanic's lien held by FTSA was void. As alleged by Buchanan, the Mechanic's Lien Contract was executed *after* construction had been performed. As such, Buchanan seeks the benefit of a secret agreement which would contradict the express terms of the Mechanic's Lien Contract, and would invalidate a facially valid instrument. Clearly, Buchanan, by executing the Mechanic's Lien Contract when work had already begun, lent herself to a scheme likely to mislead banking authorities. As such, Buchanan's claims are barred by the *D'Oench, Duhme* doctrine.

By purchasing the asset at issue from the FSLIC, as receiver for FTSA, First Gibraltar acquired the protections afforded FSLIC under federal law. Although Buchanan contends that First Gibraltar had "notice" of her alleged defense, First Gibraltar's protections are not defeated by a public filing such as a *lis pendens*. In any event, recent case law is clear that this type of "notice" will not defeat such protections.

ARGUMENT AND AUTHORITIES

I. FEDERAL LAW PRECLUDES BUCHANAN'S ASSERTION THAT THE LIEN ON HER HOMESTEAD WAS INVALID

A. The D'Oench, Duhme Doctrine Bars Buchanan's Claims

Buchanan contends that because FTSA allegedly failed to obtain her signature prior to commencing construction, the lien created against her homestead was void. Because the lien was invalid, Buchanan asserts, no title or interest in her home passed from FSLIC to First Gibraltar, so that the *D'Oench, Duhme* doctrine and §1823(3) are inapplicable. The protections afforded First Gibraltar by federal law, however, override Buchanan's purported homestead protection in this case.

The Court below properly determined that the *D'Oench, Duhme* doctrine barred Buchanan's claim, because she had lent herself to a scheme likely to mislead regulators. In *D'Oench, Duhme & Co. v. FDIC*, 315 U.S. 447 (1942), the United States Supreme Court articulated a policy designed to preclude claims not appearing on the face of the records of a savings and loan or bank placed in receivership. In *D'Oench, Duhme*, this Court held that secret agreements designed to deceive the banking authorities, or that would tend to have that effect, may not be asserted as a defense against the FDIC suing in its corporate capacity. The underlying rationale of the rule is that banking authorities are entitled to rely on the books and records of a financial institution. Thus, a person who, to accommodate a bank, executes an instrument which is in the form of a binding obligation, is estopped from

arguing that the parties agreed that the instrument would not be enforced. *D'Oench, Duhme*, 315 U.S. at 461; *FSLIC v. Wilson*, 722 F.Supp. 306, 312 (N.D. Tex. 1989).

D'Oench, Duhme and its progeny have since been extended far beyond the situation in which the lender and borrower secretly agree that an obligation will not be enforced. Moreover, Congress enacted Section 1823(e) of Title 12 which provides:

> [N]o agreement which tends to defeat the interest of the Corporation and any asset acquired by it under this section or section 1821 of this title, either as security for a loan of by purchase or as receiver of any insured depository institution, shall be valid against the Corporation unless such agreement (1) shall be in writing, (2) was executed by the depository institution and any person claiming an adverse interest thereunder, including the obligor, contemporaneously with the acquisition of the asset by the depository institution, (3) was approved by the Board of Directors of the depository institution or its loan committee, which approval shall be reflected in the minutes of said board or committee and (4) has been, continuously, from the time of its execution, an official record of the depository institution.

This Court construed §1823(e) expansively in *Langley v. FDIC*, 484 U.S. 86 (1987). In *Langley*, the Langleys alleged that the insolvent bank had misrepresented certain existing facts upon which they relied in executing the note that was the subject of the lawsuit; however, no reference to the alleged representations appeared in the records of the failed bank. This Court held that under §1823(e) a borrower who signs a facially unqualified note subject to

unwritten conditions or understandings "has lent himself to a scheme or arrangement whereby the banking authority . . . was likely to be mislead, whether the condition consists of performance of a counterpromise (as in *D'Oench, Duhme*), or of the truthfulness of a warranted fact." *Id.* at 90. Accordingly, the Court rejected the Langleys' claims and found them liable on the note.

As noted by the Fifth Circuit, the aims of both §1823(e) and *D'Oench, Duhme* are identical, and the reasoning applied in §1823(e) cases is applicable to *D'Oench, Duhme* cases. *Olney Savings & Loan Ass'n v. Trinity Banc Savings Ass'n*, 885 F.2d 266, 274 (5th Cir. 1989). The Fifth Circuit has also extended the protections of *D'Oench, Duhme* to private parties, such as First Gibraltar, that purchase the assets of a failed institution from the FDIC (or formerly, the FSLIC). *Porras v. Petroplex Savings Ass'n.*, 903 F.2d 379, 381 (5th Cir. 1990). Thus, the policies and protections arising from §1823(e) and *D'Oench, Duhme* are applicable to this case.

In *FSLIC v. Griffin*, 935 F.2d 691 (5th Cir. 1991), the closed institution, and later First Gibraltar, pursued Griffin on a deficiency suit based on a guaranty. Griffin asserted four affirmative defenses: breach of partnership duties, usury, wrongful foreclosure, and breach of an agreement to fund. In affirming the summary judgment in favor of First Gibraltar, the Fifth Circuit stated:

> Griffin also tries to avoid application of *D'Oench, Duhme* by arguing that First Gibraltar failed to prove that *D'Oench, Duhme* applies to Griffin's defenses for two reasons. One, First Gibraltar allegedly failed to prove that the four

> affirmative defenses are based on secret agreements. Two, First Gibraltar allegedly failed to prove the Griffin lent himself to a "scheme" to mislead the banking authorities.
>
> The requirements of *D'Oench, Duhme* are met. The agreements alleged here are unenforceable because they are not reflected in the bank's records. *Campbell Leasing, Inc. v. Federal Deposit Ins. Corp.*, 901 F.2d 1244, 1248 (5th Cir. 1990). They need not be "secret," only outside the bank's records. In addition, an actual scheme is not required as Griffin alleges. All that is relevant is that the agreements are not in the files. Such unfiled agreements leave the regulators without warning that they exist. "Even Borrowers who are innocent of any intent to mislead banking authorities are covered by the doctrine if they lend themselves to an arrangement which is likely to do so." *Id.* The alleged side oral agreements (i.e. agreement to form a partnership, agreement to fund subsequent loans, and the agreement to bid in the property at a specified price) all have the effect of misleading regulatory authorities.

Griffin, 935 F.2d at 698-99. As dictated by the *Griffin* decision, proof of a "scheme" or a "secret agreement" is not necessary for application of the *D'Oench, Duhme* doctrine.

Similarly, the courts have held under federal law, banking authorities "are likely to be mislead" if an obligor is permitted to assert some arrangement which does not appear in the official records of a failed bank and which has the effect of reducing the value of assets formerly held by the failed institution. *Chatham Ventures*

v. FDIC, 651 F.2d 355, 361 (5th Cir. 1982), *cert. denied*, 456 U.S. 972 (1982). It is not necessary that the underlying transaction be fraudulent. *Beighley v. FDIC*, 868 F.2d 776, 784 (5th Cir. 1989). Several types of transactions meet this test.

Courts have applied *D'Oench, Duhme* to bar assertion of oral side agreements in several circumstances. For example, in one case, a borrower executed a promissory note in blank, with the agreement by a bank officer that the guaranty would not be filled in or enforced. When the FDIC later sought to enforce the note after it had been filled in by the bank officer, the borrower argued that his agreement rendered the note enforceable. In rejecting this argument, the Fifth Circuit held that the borrower had lent himself to a scheme likely to mislead banking authorities, because the note was facially valid. *FDIC v. McClanahan*, 795 F.2d 512, 516-17 (5th Cir. 1986). Buchanan seeks to assert just such a side agreement.

Buchanan's entire case depends upon the argument that the Mechanic's Lien Contract is unenforceable because construction had begun, despite the contract's representation to the contrary. Clearly, Buchanan is asserting collateral issues not raised by the records of FTSA. Although discovery was not conducted due to the short time First Gibraltar was involved in this action, Buchanan's claim necessarily rests upon the existence of an oral side agreement – either that the Mechanic's Lien Contract would not be enforced against her home, due to its "invalidity", or that the contract would be enforceable despite the on-going construction. Nowhere is any agreement reflected in FTSA's records. Because the Mechanic's Lien Contract is valid on its face, Buchanan lent herself to

a scheme likely to mislead banking authorities. It was Buchanan's *choice* to execute the Mechanic's Lien Contract, and she is subject to the consequences. *Accord Langley*, 108 S.Ct. at 402; *Beighley*, 868 F.2d at 784; *McClanahan*, 795 F.2d at 516-17. Buchanan's contention that the alleged "voidness" of the mechanic's lien renders the federal protections inapplicable is likewise misplaced.

Buchanan's claims are similar to those that were before the Fifth Circuit in *Templin v. Weisgram*, 867 F.2d 240 (5th Cir.), *cert. denied*, ___ U.S. ___, 110 S.Ct. 63 (1989). In *Templin*, the borrowers made an oral agreement with the bank and a third party to loan money to the borrowers, secured by the borrowers' homestead, through a simulated sale to the third party. The parties executed a warranty deed, promissory note and deed of trust, all of which were facially valid. None of the bank's records contained the parties' oral agreement. After the bank failed, the borrowers defaulted on their note, and the FDIC posted the property for foreclosure. One of the borrowers then sought an order restraining the foreclosure sale, arguing that the deed of trust was void under Art. 16, §50 of the Texas Constitution, which declares any pretended sale of a homestead void.

As in this case, the borrower contended that, because the simulated sale was void, §1823(e) was inapplicable because no "right, title or interest" passed to the FDIC. The Fifth Circuit expressly rejected the borrower's contention, holding that:

> Given the focus of section 1823(e), *it is the manner in which an instrument is proven to be void*, not the conclusion that the instrument is void, that determines whether it is within the statute.

Templin, 867 F.2d at 242 (emphasis added). Clearly, Buchanan seeks to void a facially valid instrument by raising collateral issues or agreements not appearing on the fact of the instrument, and which actually contradict the terms of the instrument. While First Gibraltar realizes the broad range of protections given to one's homestead, the policy of avoiding the effect of unrecorded side agreements "overrides even such protections as the homestead exemption protection, like mechanic's liens, under the Texas Constitution." *Aero Support Systems, Inc. v. FDIC*, 726 F.Supp. 651, 653 (N.D. Tex. 1989) (citing *Templin*).

Buchanan's reliance upon the Fifth Circuit's decision in *Patterson v. FDIC*, 918 F.2d 540 (5th Cir. 1990), is also misplaced. Buchanan claims she has been denied equal protection because the Court's opinion below conflicts with the *Patterson* opinion. In *Patterson*, however, the deed of trust was *void* because it was not a purchase money lien or mechanic's lien, therefore, it could *never* attach. In this case, however, the lien contract executed by Buchanan *could* validly attach a lien to her homestead, but for the alleged status of the work. Her current efforts to contradict the terms of a facially valid agreement present a classic *D'Oench, Duhme* situation. Thus, the facts presented here are significantly different than those present in *Patterson* and there is no "conflict" of decision or denial of equal protection.

B. First Gibraltar's Alleged "Notice of Buchanan's Claims Does Not Defeat Its Federal Law Protections

Buchanan also contends that, because she filed a notice of *lis pendens* regarding her claims, First Gibraltar

had "notice" of her claims. Buchanan's contention is misplaced, however, because the critical issue is that there is no evidence of the agreement between Buchanan and FTSA, whatever its nature, in the bank's records. The only purported "notice" was a one page Notice of *Lis Pendens* filed in the county records.

As the Court below noted, the very speed of purchase and assumption transaction necessitates a hasty review of bank records. *Buchanan v. FSLIC*, 935 F.2d 83, 86 n.5 (5th Cir. 1991). *See also Gunther v. Hutcheson*, 674 F.2d 862, 865 (11th Cir.), *cert. denied*, 459 U.S. 826 (1982). Federal regulators are under no duty to search a bank's records to find evidence of a claimed lien or public notice. *Aero Support*, 726 F.Supp. at 653; *see also FDIC v. Wood*, 758 F.2d 156, 162 (6th Cir. 1985). Such a duty would impose an unrealistic and unreasonable burden on bank regulators, who must be allowed to rely upon the records in the files of the bank when structuring a purchase and assumption transaction. *See FSLIC v. Murray*, 853 F.2d 1251, 1256 (5th Cir. 1988). Accordingly, the Fifth Circuit was correct in its determination that Buchanan's claim of "notice" was "without merit".

CONCLUSION

Simply put, Buchanan is attempting to avoid the effect of an instrument, *valid on its face*, by raising collateral issues not apparent from FTSA's records, and which contradict the express terms of the instrument. Buchanan can only void FTSA's lien by proper written proof concerning the validity of the underlying agreements.

Buchanan has none. First Gibraltar, as transferee from the FSLIC, is entitled to the protections afforded by the *D'Oench, Duhme* doctrine. As such, Buchanan's claims must fail, and the Court's opinion below was in all things correct.

Respectfully submitted,

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